

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 03-0023**  
**Gross Income Tax**  
**For the Years 1997-2001**

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**ISSUES**

**I. Gross Income Tax-Unsegregated receipts**

**Authority:** Ind. Code § 6-2.1-2-3; Ind. Code § 6-2.1-2-4; Ind. Code § 6-2.1-2-7.

Taxpayer protests the imposition of gross income tax at the high rate for payments with respect to contracts in which services and material were not otherwise separately stated, when taxpayer had other, separate contracts that broke out labor and materials separately, and other contracts for labor only and materials only.

**II. Gross Income Tax-Asset sale proceeds**

**Authority:** 11 U.S.C. § 1146(c); *In re 995 Fifth Avenue Associates, L.P.*, 963 F.2d 503, 511 (2<sup>nd</sup> Cir. 1992); *In re Jacoby-Bender, Inc.* 40 B.R. 10 (Bankr. E.D.N.Y. 1984), *aff'd* 758 F.2d 840 (2<sup>nd</sup> Cir. 1985); *Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue*, 806 N.E.2d 381 (Ind. Tax 2004).

Taxpayer protests the imposition of gross income tax with respect to sale proceeds of taxpayer with respect to a sale of property to a new corporation while taxpayer's business was in bankruptcy.

**III. Tax Administration – Interest**

**Authority:** Ind. Code § 6-8.1-10-1; 11 U.S.C. § 502(b)(2).

Taxpayer protests the imposition of interest after the date taxpayer filed for bankruptcy.

**IV. Tax Administration - Penalty**

**Authority:** Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2(b).

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

## **STATEMENT OF FACTS**

Taxpayer is a business engaged in automobile windshield repair and replacement. During the taxable years in question, taxpayer had several transactions, which can best be summarized into four categories: labor only, materials only, materials and labor, and “one-stop” transactions, in which labor and materials were not separately itemized. As a result of audit, Department reclassified receipts for “one-stop” transactions for gross income tax from the low (0.3%) rate to the high (1.2%) rate. In so doing, the Department used a cross-sample of receipts for one month, determined the percentage of receipts that were unsegregated receipts-approximately seventy-eight percent of its total receipts-to the total amount of all receipts for that month, then applied the percentage to total receipts for the years in question. Taxpayer agrees with the method for determining the percentage of receipts that were unsegregated; however, taxpayer protests the imposition of the tax at the higher rate on the entire amount of those receipts, rather than a percentage based on the material-labor ratio of the receipts that showed such amounts separately.

During 2000, taxpayer filed for bankruptcy. As part of the bankruptcy, taxpayer sold all of its capital assets other than real estate to a new corporation. Audit assessed gross income tax on the proceeds from the sale. Taxpayer has also protested this assessment, stating that the federal bankruptcy law forbids the assessment of this tax in the case of bankruptcy. Taxpayer also protests the assessment of interest from the date of its bankruptcy filing to present, stating that its bankruptcy order prohibits the assessment of post-petition interest, and protests the penalty for negligence.

### **I. Gross Income Tax-Unsegregated receipts**

## **DISCUSSION**

Taxpayer protests the imposition of gross income tax at the high rate. In general, a taxpayer’s receipts from transactions stated in Ind. Code § 6-2.1-2-4-generally, the sale of tangible personal property- are taxable at a rate of 0.3%. Ind. Code § 6-2.1-2-3(a). However, receipts from other transactions are taxable at a rate of 1.2%. Ind. Code § 6-2.1-2-3(b). Further, if a taxpayer does not specify with respect to its records whether the transaction is subject to tax at the high rate or at the low rate, it is taxable at the high rate. Ind. Code § 6-2.1-2-7.

In this instance, taxpayer’s records did not reflect what portion of the sales represented the products provided and what portion represented the labor to install the products. Even if taxpayer’s method of setting forth the portions of material and labor is a reasonable representation of each portion, taxpayer has not separately stated the portions taxable at the low rate and at the high rate. Therefore, taxpayer is taxable on the unsegregated receipts at the high rate.

## **FINDING**

Taxpayer’s protest is denied.

### **II. Gross Income Tax-Asset sale proceeds**

## DISCUSSION

Taxpayer also protests the assessment of gross income tax with respect to its sale of operating assets as part of its bankruptcy reorganization. No apparent argument exists with respect to the proper imposition of the gross income tax other than the those related to the bankruptcy code. In particular, taxpayer argues that the gross income taxes imposed by Indiana would be in violation of 11 U.S.C. § 1146(c). That section states “[t]he issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.”

The statute in question has been held to be applicable generally for stamp or other nominal taxes associated with the transfer of property by written document. Elements include that the taxes

(1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is determined by the consideration for, par value of, or value of the item being transferred; (3) the tax rate is a relatively small percentage of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state **[\*\*26]** documentary transfer taxes, the tax must be paid as a prerequisite to recording.

*In re 995 Fifth Avenue Associates, L.P.*, 963 F.2d 503, 512 (2<sup>nd</sup> Cir. 1992). In general, the court in that case noted that stamp taxes, undefined in the bankruptcy code, generally were nominal- less than one percent of the recited consideration. *Id.* at 511. However, in the case of income taxes imposed on associated gains with transfers of property, the statute has been held to not be applicable. *Id.* at 513; *In re Jacoby-Bender, Inc.* 40 B.R. 10 (Bankr. E.D.N.Y. 1984), *aff'd* 758 F.2d 840 (2<sup>nd</sup> Cir. 1985). In these cases, the taxpayers, companies which had filed for bankruptcy, sold real estate in New York, and realized a gain on the sale of the property. New York sought to impose a gains tax of ten percent on the gain realized by taxpayer. Taxpayer, however, maintained that the bankruptcy laws prohibited assessment of the tax. The court, noting that the tax was only imposed on the gain from the sale, that the only use of consideration was measurement of the gain, and that the tax rate of ten percent was much greater than stamp taxes, permitted the gains tax assessment to stand.

In the present case, the gross income tax that the Department seeks to impose against taxpayer is different than a prohibited stamp or similar tax. While the tax has certain elements of the test provided by *955 Fifth Avenue Associates*- the taxes are only imposed at the time of transfer or sale of the item at issue, the gross income tax is measured by the proceeds of the sale, and the tax is imposed at low rates- either 0.3% or 1.2%- the gross income tax is not a state documentary transfer tax, and thus the issue of payment as a prerequisite for reporting does not arise. It is a tax on the privilege of receiving income derived from sources in the state of Indiana. *Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue*, 806 N.E.2d 381 (Ind. Tax 2004) (citing *Miles v. Dep't of Treasury*, 209 Ind. 172, 199 N.E. 372 (Ind. 1935)). As such, the tax is

not a stamp or similar tax, and accordingly the tax does not fall within the ambit of proscribed taxes under the federal bankruptcy code.

### **FINDING**

Taxpayer's protest is denied.

### **III. Tax Administration-Interest**

#### **DISCUSSION**

Taxpayer protests the imposition of interest from the date taxpayer filed for bankruptcy to present. Taxpayer argues that the filing of the bankruptcy petition precludes the Department from assessing interest against the taxpayer, and therefore this should be waived.

Under Ind. Code § 6-8.1-10-1, interest cannot be waived by the Department. However, because of the Bankruptcy Court's ruling, post-petition interest cannot be assessed under 11 U.S.C. § 502(b)(2).

### **FINDING**

Taxpayer's protest is sustained.

### **IV. Tax Administration-Penalty**

#### **DISCUSSION**

Taxpayer protests the imposition of the ten percent (10%) negligence penalty for all taxes that the Department has imposed.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2. The Indiana Administrative Code further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was

due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

With respect to taxpayer's protest, taxpayer's failure to properly compute and remit tax on a substantial majority of its total receipts, despite clear statutory authority, does not give rise to an inference of reasonable care by the taxpayer. However, for the taxable year of its bankruptcy, 2001, taxpayer has presented reasonable cause for that year only.

### **FINDING**

Taxpayer's protest is denied for taxable years 1997-2000. Taxpayer's protest is sustained with respect to taxable year 2001.